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In the Supreme Court of the United States

OCTOBER TERM, 1989

NICHOLAS H. MORLEY, ET AL., PETITIONERS

v.

FEDERAL DEPOSIT INSURANCE CORPORATION

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE ELEVENTH CIRCUIT

BRIEF FOR THE RESPONDENT IN OPPOSITION

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QUESTION PRESENTED

Whether the court of appeals correctly held that, where the Federal Deposit Insurance Corporation acquired a note from a troubled bank in a financial-assistance transaction, debtors of the assisted institution lacked standing to challenge the statutory basis for the assistance plan.

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OPINIONS BELOW

The opinion of the court of appeals (Pet. App. 1-25) is reported at 867 F.2d 1381. The orders of the district court (Pet. App. 26-41) are unreported.

JURISDICTION

The judgment of the court of appeals was entered on March 16, 1989. The petition for a writ of certiorari was filed on June 14, 1989. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

STATEMENT

1. In April 1981, Continental Illinois National Bank and Trust Company of Chicago, an institution insured by the Federal Deposit Insurance Corporation, loaned peti-

tioners $37,000,000. Petitioners used the proceeds to purchase land and to construct a condominium project in Miami, Florida. Petitioners defaulted on their repayment obligation in November 1982. After a series of extensions on the loan maturity date, Continental in August 1986 refused to grant any further extensions and declared the notes and mortgages in default. Petitioners still owed Continental almost $31,000,000 in outstanding principal. Pet. App. 4.

By 1984, Continental itself had encountered severe financial difficulties. In significant part as a result of nonperforming loans, the bank had trouble meeting short-term funding requirements. In July 1984, the FDIC approved a plan to provide $4.5 billion in assistance in order to alleviate the bank's liquidity crisis and to prevent the bank's closure. Pet. App. 4-5.[1]

The assistance plan had three parts. Under the first part, Continental transferred to the FDIC $2 billion worth of troubled loans, in exchange for which the FDIC assumed $2 billion of Continental's debts. Under the second part, Continental gave the FDIC a note for $1.5 billion, which, it was agreed, could be paid off by Continental's delivering to the FDIC $1.5 billion in additional loans over the succeeding years. In exchange, the FDIC agreed to assume an additional $1.5 billion in debt that Continental owed to the Federal Reserve Bank of Chicago. Under the third part

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[1] Under 12 U.S.C. 1823(c)(1), the FDIC is authorized "to make loans to, to make deposits in, to purchase the assets or securities of, to assume the liabilities of, or to make contributions to, any insured bank" in order to prevent closure of the bank and to lessen the risk to the FDIC insurance fund posed by the instability of insured banks with significant financial resources. See Pet. 3-4; Pet. App. 7. The statute also provides that the FDIC may carry out the specified actions "in its sole discretion and upon such terms and conditions as the [FDIC's] Board of Directors prescribe." 12 U.S.C. 1823(c)(1).

of the assistance plan, the FDIC, in order to infuse additional capital into Continental, purchased $1 billion of preferred stock from Continental's holding company, Continental Illinois Corporation (CIC), which agreed to invest in the bank the $1 billion it received from the FDIC. Pet. App. 5.[2]

In February 1987, the FDIC acquired petitioners' loan from Continental. The acquisition occurred pursuant to the second part of the 1984 assistance plan, which allowed Continental to pay off its $1.5 billion note to the FDIC by transferring loans to the FDIC. Pet. App. 6.

2. In March 1987, the FDIC sued petitioners in the United States District Court for the Southern District of Florida, seeking to collect the outstanding borrowed amount and to foreclose on the property used as collateral. Petitioners, who did not dispute their failure to repay the outstanding balance, asserted several affirmative defenses, such as estoppel, waiver, fraud, and breach of fiduciary duty, all based on an alleged oral agreement between petitioners and Continental. Petitioners also counterclaimed for a declaration that the FDIC's acquisition of the loan was invalid. They asserted principally that the purchase of the holding company's stock as a means of infusing capital into the bank was beyond the authority granted the FDIC by 12 U.S.C. 1823(c). Pet. App. 6-7.

On the FDIC's motion to strike the affirmative defenses and to dismiss the counterclaim, the district court ruled first that the defenses were barred by 12 U.S.C. 1823(e). That provision protects the FDIC against the assertion of defenses based on unwritten side agreements that would

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[2] The bank's previous issuance of bonds containing restrictive covenants prevented the FDIC from injecting capital directly into the bank; there was not sufficient time for the FDIC to secure the bondholders' waiver of the covenants. Pet. App. 5 n.1.

diminish or defeat the FDIC's interest in a note acquired pursuant to Section 1823. See *Langley* v. *FDIC*, 484 U.S. 86 (1987).[3] The district court held that the provision applied to petitioners' loan, and barred the defenses. Pet. App. 7-9; *id.* at 26-31.[4]

The district court also held that petitioners lacked standing to maintain their counterclaim challenging the validity of the Continental assistance plan. The court concluded that the harm suffered by petitioners—the loss of their affirmative defenses—was caused by their own failure to place in writing the alleged unrecorded modifications to their loan agreements, but was not fairly traceable to the allegedly invalid assistance plan. Pet. App. 31-35. Accordingly, the court struck the counterclaim as well as the affirmative defenses and, because there was no dispute about petitioners' failure to repay their loans, granted summary judgment to the FDIC and ordered a foreclosure sale. *Id.* at 9-10, 31-41.

3. The court of appeals affirmed. Pet. App. 1-25. Petitioners' sole contention was that Section 1823(e), which they now conceded would bar their defenses to repayment if it applied, was inapplicable because the FDIC did not lawfully acquire their loan under Section 1823(c). They argued that the FDIC financial assistance plan was unauthorized by statute because the FDIC paid money to the bank holding company rather than to the

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[3] Section 217 of the Financial Institutions Reform, Recovery, and Enforcement Act of 1989, Pub. L. No. 101-73 (Aug. 9, 1989), amends 12 U.S.C. 1823(e), but the changes are not material to the present case. See H.R. Conf. Rep. No. 222, 101st Cong., 1st Sess. 79 (1989).

[4] The district court rejected petitioners' argument that Section 1823(e) did not, and could not, apply to loans that were acquired by the FDIC after the initial transfer of assets under the assistance plan in 1984. Petitioners did not challenge that ruling in the court of appeals (see Pet. App. 9 n.5) and do not challenge it in this Court.

bank. The court of appeals, declining to address the merits of petitioners' contention, held that petitioners did not have standing to challenge the lawfulness of the assistance plan. Pet. App. 12-25.

The court found that petitioners failed to meet any of the minimum constitutional requirements for standing. The court first concluded that petitioners' alleged injury—the loss of affirmative defenses—was not judicially cognizable. The court reasoned that this loss was "the natural consequence of a valid congressional enactment" (12 U.S.C. 1823(e)). Pet. App. 14-15.

The court next ruled that petitioners' loss of their defenses was, in any event, not fairly traceable to the 1984 assistance plan. First, the court concluded, the loss of defenses was the direct result of petitioners' own failure to secure the alleged agreements in writing in conformity with Section 1823(e), a failure that persisted throughout the three years between 1984 and the FDIC's 1987 acquisition of their loan even though petitioners knew the FDIC could acquire the loan at any time. In addition, the court concluded, the alleged wrong—the FDIC's infusion of money into CIC, the bank holding company—was not a cause of petitioners' loss of defenses, because the CIC capital infusion took place under a part of the assistance plan quite separate from the part, whose legality is not challenged, under which the FDIC acquired petitioners' loan. The court therefore ruled that petitioners "would have lost [their] defenses even without the allegedly improper infusion of capital into CIC." Pet. App. 18; see *id.* at 16-18.

The court of appeals also held that, even if the district court were to agree with petitioners' claim that the CIC capital infusion was unlawful, the relief would not likely restore petitioners' defenses. First, the district court could separate the three parts of the assistance plan, leaving the

loan-acquisition portions in place and Section 1823(e) applicable. Second, the trial court could find the assistance plan valid even though not authorized by Section 1823(c), in which event, the court of appeals observed, the federal common law doctrine of *D'Oench, Duhme & Co.* v. *FDIC,* 315 U.S. 447 (1942), would likely preclude petitioners' defenses. Pet. App. 20-21 n.8. Third, if the trial court found the entire assistance plan invalid, petitioners still would not gain relief. Such a finding, the court of appeals explained, would place Continental in failing condition and in need of FDIC assistance. The result would be that the FDIC would modify the 1984 assistance plan, and the desire to avoid confusion would likely lead the FDIC to acquire the same loans it already possesses, including petitioners'. Pet. App. 18-21.

Having found no constitutional standing, the court of appeals also ruled that prudential considerations defeated standing. Citing *Clarke* v. *Securities Industry Ass'n*, 479 U.S. 388 (1987), the court held that a bank's debtors fall outside the zone of interests protected by the Federal Deposit Insurance Act, 12 U.S.C. 1811 *et seq.*, and Section 1823 in particular. The court explained that the Act in general, and Section 1823 especially, were enacted to protect the interests of depositors and bank shareholders, not the interests of debtors; indeed, it was debtors that Section 1823 was specifically designed to protect depositors and shareholders *against*. Pet. App. 22-24.

Finally, the court of appeals concluded that common sense counsels against recognizing petitioners' standing. The court observed that, in devising assistance plans designed to prevent bank failures, the FDIC must act expeditiously. Permitting challenges to assistance plans by the numerous debtors whose loans are routinely acquired

in such plans would greatly impair the FDIC's ability to offer timely assistance to troubled banks. Pet. App. 24.

ARGUMENT

The court of appeals' holding that petitioners lacked standing to contest the validity of the FDIC's 1984 financial assistance plan for Continental is correct and does not warrant this Court's review. Petitioners do not allege that the ruling of the court of appeals conflicts with any decision of any other court of appeals; and in fact, no court has held that debtors may challenge a financial assistance plan like the one at issue here.[5] Nor is there any other reason suggesting that the issues presented are of special importance.

1. The court of appeals correctly concluded that petitioners failed to meet the minimal Article III requirements of standing. See *Allen* v. *Wright*, 468 U.S. 737, 751 (1984) (Article III requires that plaintiff have suffered "personal injury fairly traceable to the defendant's allegedly unlawful conduct and likely to be redressed by the requested relief"). In particular, as the court of appeals held (Pet. App. 16-18), petitioners' asserted injury (the loss of an opportunity to establish their affirmative defenses) was not fairly traceable to the allegedly illegal action of the FDIC (the infusion of funds into CIC, the bank holding company, allegedly in excess of the authority granted to the FDIC by Section 1823(c)).

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[5] Two district courts have held that obligors – in one case a borrower, in the other an accountant malpractice defendant – lacked standing to challenge the Continental assistance plan because their alleged injury was not fairly traceable to the plan. *FDIC* v. *Main Hurdman*, 655 F. Supp. 259 (E.D. Cal. 1987); *FDIC* v. *WH Venture*, 607 F. Supp. 473 (E.D. Pa. 1985).

The alleged illegality occurred in a part of the assistance plan that was separate from the part under which the loan was acquired. The latter part, involving the FDIC's assumption of debts owed by Continental in exchange for certain assets plus a note that could be paid off by Continental's transferring other loans to the FDIC, is not challenged as illegal, and it stands independently of the CIC capital infusion part of the plan. The alleged legal defect in the CIC capital infusion was not the but for cause of the FDIC's acquisition of petitioners' loan pursuant to the loan-acquisition portion of the assistance plan. As the district court concluded in *FDIC* v. *Main Hurdman*, 655 F. Supp. 259, 270 (E.D. Cal. 1987), "[t]here is absolutely no reason to believe that if [the FDIC had injected capital directly into Continental]"—which would have eliminated the basis for petitioners' allegation of illegality under Section 1823(c)—"a different arrangement would have been made; on the contrary, it seems apparent that the exact same assignment [of petitioners' loan] would have resulted." Any contrary assumption is thus too speculative to support a claim of standing.

In addition, even if the loss of defenses had some nexus to the CIC capital infusion, that nexus was broken by petitioners' own conduct following the implementation of the assistance plan. Petitioners knew from 1984 until the FDIC acquired their loan in 1987 that the FDIC could acquire the loan at any time pursuant to the loan-acquisition portion of the assistance plan. Pet. App. 16-17. Yet petitioners failed to take any steps to place in writing, and otherwise to bring into conformity with Section 1823(e), the alleged agreements that they later asserted as defenses against the FDIC when it acquired their loan. Since petitioners were on notice of the potential loss of defenses, that failure was an intervening cause that, in itself, renders

any connection between the alleged injury and the 1984 CIC capital infusion far "too attenuated" to support standing. *Allen* v. *Wright,* 468 U.S. at 752; see *Simon* v. *Eastern Kentucky Welfare Rights Org.*, 426 U.S. 26, 42-44 (1976).[6]

2. The judgment below is also independently supported by the court's additional holding that the prudential zone-of-interests analysis precluded petitioners' standing.[7] Petitioners do not dispute the court of appeals' conclusion that their interests as debtors are not within the zone of interests protected by the Federal Deposit Insurance Act in general and Section 1823 in particular. In fact, Section 1823 and the other provisions of the Act are designed to protect the interests of depositors and shareholders, whose claims against troubled banks depend on the FDIC's exercise of its duties and authority under the Act; they are not designed to protect the interests of debtors, whose obligations to the banks are the banks' principal assets. Indeed, to the extent that Section 1823 addresses debtors, it is specifically to protect banks *against* debtors' assertion of various interests. See 12 U.S.C. 1823(e).[8]

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[6] Because the fair traceability component of Article III standing is not satisfied, the court of appeals' more problematic rulings regarding the injury-in-fact and redressability components were not necessary to its constitutional holding.

[7] The question presented in the petition (Pet. i) challenges only the court of appeals' constitutional holding and thus does not encompass the court's prudential zone-of-interests ruling. In the "reasons for granting the petition" portion of their filing, petitioners do challenge the zone-of-interests ruling.

[8] Cf. *FDIC* v. *Freudenfeld,* 492 F. Supp. 763, 768-769 (E.D. Wis. 1980) (debtors have no standing to challenge receiver's distribution of assets); *FDIC* v. *Lesselyoung,* 476 F. Supp. 938, 946 (E.D. Wis.), aff'd, 626 F.2d 1327 (7th Cir. 1980) (debtors have no standing to

Petitioners contend, instead, that the case presents the question whether the zone-of-interests test should "cut against Article III standing." Pet. 12. They also suggest that the test applies only to claims for review of agency action under the Administrative Procedure Act (APA), 5 U.S.C. 702 (authorizing judicial review by any "person suffering legal wrong because of agency action, or adversely affected or aggrieved by agency action within the meaning of a relevant statute") and is for that reason not applicable here. Pet. 13. Those contentions are without merit.

a. The court of appeals did not apply the zone-of-interests test as part of its constitutional inquiry. Rather, in accordance with well-established precedent (*Clarke* v. *Securities Industry Ass'n, supra*; *Association of Data Processing Service Orgs., Inc.* v. *Camp,* 397 U.S. 150, 153 (1970)), the court applied the test as an additional, non-constitutional requirement that a litigant must meet when, as here, the litigant makes a claim under a statute. Pet. App. 22.

b. Petitioners' APA argument is misplaced for several reasons. First, the present case involves the filing of a counterclaim that, in fact if not by virtue of petitioners' express allegations, falls squarely under Section 702 of the APA: petitioners have alleged that the FDIC, a governmental agency, took action in excess of its authority under 12 U.S.C. 1823(c). Second, to the extent that Section 702 of the APA is not applicable here, petitioners' reliance on *Clarke* cannot aid them: *Clarke* did not hold that the zone-of-interests test was limited to APA claims; it stated only

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challenge FDIC's refusal to accept all liabilities in connection with transferred assets); *FDIC* v. *Moore,* 448 F. Supp. 493, 496 (D.S.C. 1978) (borrower has no standing to challenge legality of FDIC's acquisition of bank assets).

that the "principal" cases in which the test has been applied have involved such claims. Indeed, the Court in *Clarke* suggested that *more* stringent prudential standing requirements for claiming a statutory violation apply where the " 'generous review provisions' " of the APA are inapplicable. 479 U.S. at 400 n.16. In the present setting, prudential considerations weigh heavily against standing, for, as the court of appeals explained (Pet. App. 24), allowing debtors to challenge an assistance plan (perhaps years after its implementation) would impair the FDIC's ability to take the speedy action required to forestall bank failures and to protect the depositors and shareholders who are within the zone of interests protected by the Federal Deposit Insurance Act.[9]

[9] Contrary to petitioners' suggestion (Pet. 12, 14), the court of appeals did not rule that free-standing common sense considerations defeat otherwise-available standing. Rather, as the court explained (Pet. App. 24), its conclusion that debtors are outside the zone of protected statutory interests was supported by consideration of the practical impact that debtor standing on this issue would have on the intended functioning of the statute.

CONCLUSION

The petition for a writ of certiorari should be denied.

Respectfully submitted.

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